The Southern African Institute of Government Auditors

Qualifying Examination for Registered Government Auditors

Paper 2: Accounting

November 2010

INSTRUCTIONS TO CANDIDATES

1 Maximum marks: **160**.
2 Total time available **four hours**.
3 The marks allocated to each question are an indication of the expected length and required depth of the answer.
4 Ensure proper planning and avoid exceeding the time you have allocated for each question as suggested by the number of marks allocated to the question.
5 Present your arguments in a clear, well structured manner, using precise language and professional terms, where appropriate.
6 No books or notes are allowed in the examination room.
7 All working papers must be handed in together with all paper provided for the examination (including unused answer sheets).
8 Answers written in pencil will not be marked.
9 You are reminded that this examination will be held under the rules as set out in the document "RGA-QE Examination Matters & Examination Policy 2010".
10 You are required to observe all Examination Instructions on the separate sheet of paper handed to you before commencement of this examination.

SAIGA
ADVANCING AUDITING AND ACCOUNTABILITY

QUESTION 1 **(80 marks)**

Annual Financial Statements for the Public Service 2010

PART A **(70 marks)**

The aim of the Department of Free Communications seeks to ensure that communications services are available to the people of South Africa, and that they have access to both traditional and electronic media communications. The provision of these services facilitates a higher standard of living, accelerated economic growth and development, and improved and evolving service delivery.

The following information is available in addition to the trial balance (Attachment 1) of the Department:

1 The Thabo Commission investigated the adjudication of radio licences.

2 Aid was received from China for erecting reception towers in rural areas in the amount of R6 000. The other aid assistance was received from the SA business community for the development of human capacity. Spending took place as follows:

Aid assistance expenditure	**China**	**SA business**
Personnel	R500	
Administration	R200	
Training		R900
Equipment (Capital)	R5 000	

Unspent aid from China is due to projects that are to be finished in the next financial year. All other unspent aid will be repaid to the donor.

3 The 2010 unauthorised expenditure was because of expenses on contracting professional advice that was not acquired with the necessary approval. All unauthorised expenditure from previous years also related to current expenditure.

4 A broadcasting tower to the value of R70 000 was donated to the department by Cell D Pty Ltd.

5 The following transactions still have to be accounted for in the records of the department:

a All unauthorised expenditure from before 2010 was approved without funding.

b Fruitless and wasteful expenditure of R50 that occurred in 2008 was investigated and confirmed.

Please find the trial balance of the department as Attachment 1.

REQUIRED:
(No comparative figures needed for statements or notes)

(a) Compile a Statement of Financial Performance for the Department of Free Communications for the year ending 31 March 2010. (15)

(b) Compile a Statement of Financial Position for the Department of Free Communications on 31 March 2010. (10)

(c) Compile a Cash Flow Statement for the Department of Free Communications on 31 March 2010. (14)

(d) Show the following notes to the financial statements. (22)
i Departmental Revenue
ii Cash and cash equivalents
iii Voted funds to be surrendered to the Revenue Fund
iv Departmental revenue to be surrendered to the Revenue Fund
v Net cash flow available from operating activities

(e) Use the information from the trial balance after the adjustments have been taken into account to present the year opening and closing transactions for the annual appropriation, funds requisition (summarised for the year), expenditure against voted funds and departmental revenue in **ledger account format**. **Show only the following accounts**: (9)
i Exchequer Grant Account
ii Revenue Accrual Account

PART B **(10 marks)**

You are the auditor appointed to audit the annual financial statements of a government department. Due to certain issues that you have raised during the audit, the senior management of the department wants you to explain to them the concept of “materiality”.

You reported to them that the Accounting Standard Board’s statement explains it as follows: that information is material if its omission, misstatement, or non-disclosure could influence the decisions of users made on the basis of financial statements. Also that materiality depends on the size of the item or error judged in the particular circumstances of its omission, misstatement, or non-disclosure in the financial statements, and that certain risks associated with the activities of the department, are to be considered in assessing materiality. Now they request an explanation of the risks that you are referring to.

REQUIRED:
Write a report to the senior management of the department that sets out the most common risks, with an explanation of each risk, associated with the activities of a department that need to be considered in assessing materiality. (10)

Attachment 1: Trial balance for the Department of Free Communications on 31 March 2010

2008/09	Description	2009/10	
		Dr	Cr
	Balance Sheet items		
13 612	Paymaster General Account	15 440	
567	Deposit account	753	
3 000	Petty cash	3 000	
4 000	Debtors	7 490	
741	Subsistence and travel advances	950	
350	Unauthorised expenditure	876	
(3 200)	Cheques payable		2 850
(1 450)	Receipt control account		1 700
(200)	Bank adjustment account		350
(4 680)	EBT payment account		5 780
(8 740)	Salary deductions control account		9 200
(4 000)	Recoverable Revenue		7 490
-	Exchequer Grant Account	1 400	
	Nominal Items		
(180 000)	General Account of the Vote		280 000
-	Aid Assistance		7 000
(6 200)	Broadcasting permits issued		5 590
-	Sale of equipment (capital)		7 210
-	Material losses recovered		2 000
20 890	Salaries	21 583	
14 100	Medical aid contribution	14 500	
3 150	Pension fund contribution	3 237	
10 800	Housing subsidy	11 200	
4 000	Communication	3 970	
3 970	Training and staff development	4 321	
1 500	Travel and Subsistence (Local)	1 940	
3 000	Travel and Subsistence (Foreign)	2 591	
10 039	Advertising	6 824	
7 910	Stationery and printing	8 924	
37 981	Machinery and Equipment (capital)	23 791	
21 470	Equipment under R5000	18 600	
-	Land (capital)	36 000	
-	Copyright registration (capital)	4 000	
700	Venues and facilities	670	
4 000	Thabo commission	15 500	
25 810	ICL-computer services	31 980	
6 300	Auditing fees (regularity)	7 300	
4 380	Auditing fees (performance)	5 100	
-	SABC - Transfer payment (public corp)	20 810	
-	National Post Office - TP (public corp)	16 920	
-	NEM - Transfer Paym (non-profit)	13 700	
-	Community bursaries	4 700	
6 200	General Account of Revenue	14 500	
	Aid Assistance	6 600	
-		329 170	329 170

QUESTION 2 **(30 marks)**

PART A **(15 marks)**

1 A Municipality enters into various contracts to expand its sewerage works and incurs the following expenditure that is listed below. The Municipal Council approved the expansion of the new sewerage works on 1 July 2009 and construction commenced during July 2009 after the environmental impact study results were obtained. The environmental impact study indicated that the sewerage works could be expanded provided that the Municipality set aside money to rehabilitate the site where the sewerage works are situated when the sewerage works are eventually retired from use (estimated to be in 2050).

Date	**Description**	**Amount R**
30 April 2009	Research into whether to expand the existing sewerage works or to construct a new sewerage works	50 000
20 July 2009	Environmental impact study	25 000
31 July 2009	Design fees paid to designer	175 000
31 August 2009	Progress payment to appointed contractor (excluding retention)	3 000 000
Months of July and August 2009	Project management fees (the Municipality's Chief Engineer was the project manager). The salary of the Chief Engineer was allocated based on actual time spent on the expansion of the sewerage works)	60 000
31 August 2009	Retention withheld from appointed contractor now paid to appointed contractor	300 000
31 August 2009	Present value of rehabilitation costs	200 000

The Municipality brings the expanded sewerage works into use on 1 September 2009.

The accounting policy of the Municipality indicates that sewerage works are depreciated over 50 years.

REQUIRED:

(a) Calculate the cost of the expansion that should be included in the Municipality's fixed asset register for the year ended 30 June 2010. (5)

(b) Calculate the depreciation expense that should be included in the Municipality's fixed asset register for the year ended 30 June 2010. (2)

2 A Municipality builds a new office block for its community services directorate. It uses borrowings to finance the new office block as it does not have sufficient internal funds. The building costs R1 600 000 and will be financed from a ten year loan of R1 600 000 that incurs interest of 12% per annum. The loan is repayable in one instalment at the end of the loan period. Interest is payable quarterly.

The building takes nine months to construct. Payment for the building is made on a quarterly basis. Building commences on 1 July 2009 and the office building is ready for occupation on 1 April 2010.

The payments for the construction of the building are as follows:

Date	**Description**	**Amount R**
30 September 2009	Payment to contractor	900 000
31 December 2009	Payment to contractor	300 000
31 March 2010	Payment to contractor	400 000
TOTAL COST		1 600 000

The Municipality keeps detailed records of the borrowing used to finance the new office block. The proceeds of the borrowing are invested in a ring-fenced investment account until used to finance the office building.

An extract from the borrowing records for the period 1 July 2009 to 31 December 2009 is set out below:

Date	**Description**	**Amount R**
1 July 2009	Borrowing proceeds received	1 600 000
1 July 2009 to 30 September 2009	Interest earned on borrowing proceeds invested until used	40 000
1 July 2009 to 30 September 2009	Interest paid on borrowings	(48 000)
30 September 2009	Payment to contractor	(900 000)
1 October 2009 to 31 December 2009	Interest earned on borrowing proceeds invested until used	17 500
1 October 2009 to 31 December 2009	Interest paid on borrowings	(48 000)

You may assume that the extract from the borrowing records is correct.

REQUIRED:

(a) Calculate the borrowing costs that should be capitalised to the office building in the period 1 July 2009 to 31 December 2009 using the information that has been provided. (7)

(b) Using the information provided, when should the Municipality stop capitalising interest to the building? (1)

PART B **(15 marks)**

1 A Municipality has an accounting policy that states that it values its inventory at the lower of cost and net realisable value. The Municipality uses the first-in-first-out method of valuation to determine cost.

An extract of its inventory records is set out below.

Transaction	Date	Inventory received	Inventory Issued from stores	Balance	Value	Unit Price
Balance brought forward	**1 July 2009**			**100**	**250.00**	**2.50**
Issued by stores	31 August 2009		50	50	a	b
Purchases	30 September 2009	40		90	112.00	2.80
Issues by stores	31 January 2010		70	20	c	d
Purchases	30 June 2010	10		30	30.00	3.00
Balance carried forward	**30 June 2010**	**50**	**120**	**30**	e	f

REQUIRED:

Calculate the amounts that should be inserted to replace a, b, c, d, e and f. (5)

2 Should a Municipality distribute goods free of charge to its citizens, the net realisable value of such goods will be R Nil from the Municipality's perspective.

REQUIRED:

Explain what value should be used instead of net realisable value using the guidance provided in GRAP 12. (2)

3 A Municipality has a piece of land that it intends developing to sell to poor members of the community. The land is currently included in property, plant and equipment in the accounting records of the Municipality. The Municipality accounts for property, plant and equipment at cost, less accumulated depreciation. The intention of the Municipality is to sell the developed land within the next 12 months.

The land is developed into 50 units of equal size. Each unit is developed identically.

The following information relates to the land in question.

Cost of the land

Carrying value of land currently included in property, plant and equipment	500 000
Market value of this land	1 000 000

During the 2009/10 financial year, the following transactions relating to the development of the land took place. Of the 50 units, 40 were sold before the year-end (30 June 2010).

Costs of development

Developing the land and putting in services	250 000
Sub-division of the land into 50 units	10 000
Estimate cost of marketing and selling the units	15 000
TOTAL	**275 000**

REQUIRED:

(a) Calculate the cost of sales of the 40 units that were sold. (5)

(b) Calculate the cost of inventory of the remaining 10 units. The units are currently selling for R5 000 each. (3)

QUESTION 3 **(50 marks)**

Concept Manufacturing Limited is a multi million rand production company in Burgersfort, Mpumalanga and Concept Manufacturing Limited has a 60% interest in a subsidiary SA Transport (Pty) Ltd and a 35 % interest in an associate, Concept Distributors (Pty) Ltd.

Concept Manufacturing Limited was incorporated for the purpose of job creation in the Mpumalanga.

The following information relates to Concept Manufacturing Limited for the year ending 28 February 2010:

Provisions

1 Concept Manufacturing Limited is obligated to pay damages of R296 000 in 2010 due to a lawsuit that was lost during 2008. The company uses a discount rate of 10% to calculate the present value of the legal costs due at the end of the financial year. A provision for the year ended 28 February 2009 has been provided.

The financial accountant prepared the following extract of the schedule reflecting the discounted (present value) legal costs:

Date	**Present value**
28 February 2009	R237 414
28 February 2010	R261 155

Related parties

2 SA Transport (Pty) Ltd provided transport services to Concept Manufacturing Limited at cost plus 30%. These transport services were provided as arm length transactions. Transport services provided by SA Transport (Pty) Ltd amounted to R387 000 for the year.

3 Concept Manufacturing Limited receives a royalty of 10% on the total sales value from Concept Distributors (Pty) Ltd for products purchased from Concept Manufacturing Limited. Concept Distributors (Pty) Ltd total sales for the year amounted to R6 250 000, of which R4 180 000 contributed to goods sold, that were purchased from Concept Manufacturing Limited. Concept Manufacturing Limited sold inventories to Concept Distributors (Pty) Ltd to the value of R3 000 000. These inventories were sold as arm length transactions.

4 Concept Manufacturing Limited borrowed R1 980 000 from ABSA Bank Limited. The liability represents the largest liability of Concept Manufacturing Limited.

Property, plant and equipment

5 The following property, plant and equipment were included in the Statement of financial position on *28 February 2009*:

	Cost	**Accumulated depreciation**	**Carrying amount**
	R	**R**	**R**
Land	1 950 000	-	1 950 000
Vehicles	518 000	(290 080)	227 920
Furniture and fittings	241 000	(66 878)	174 122
Manufacturing buildings	4 950 000	(792 000)	4 158 000
Equipment	2 947 100	(2 578 713)	368 387

6 On 31 March 2009 Concept Manufacturing Limited disposed of **all** equipment for R358 000, cash.

7 During 2009 the company decided to alter the policy relating to the amount at which the manufacturing building is carried in the financial statements. The manufacturing building is revalued at net replacement value in terms of the revaluation model in IAS16, *Property, plant and equipment*.

Depreciation for the **current year** will be calculated on the new revalued amount. The revaluation reserve will be transferred to equity when used. On revaluation, the accumulated depreciation of the equipment is offset against the gross carrying amount.

On 1 March 2009, the manufacturing building was revalued for the first time, by an independent sworn appraiser who holds a relevant professional qualification and has been doing revaluations like these for the past ten years. On 1 March 2009, the **gross replacement value** of the manufacturing building amounted to R5 500 000.

8 A **new production unit** was ordered on 1 February 2009 and was delivered on 1 April 2009 at the manufacturing building of Concept Manufacturing Limited in Burgersfort. The total price of the production unit, excluding transport and installation, was R3 249 000 cash.

The production unit was transported and delivered at a cost of R92 000, cash. Installation costs amounted to R82 000, cash.

Concept Manufacturing Limited was awarded a government grant of R423 000 to purchase the new production unit to facilitate job creation. You can assume that the grant is allocated to the total cost of the production unit. The production unit was available for use as intended by management on 30 April 2009.

The **total** cost price of the new production unit, after taking into consideration the government grant, can be split into two components in terms of the component approach in IAS16, *Property, plant and equipment*.

The details of the two components are as follows:

Component	% of total cost price
Production equipment	75 %
Production control system	25 %

For the year ended 28 February 2010 Concept Manufacturing Limited manufactured 148 units.

9 Concept Manufacturing Limited altered the depreciation method of furniture and fittings from the reducing balance method to the straight-line method for the year ended 28 February 2010. The *remaining* useful life as on 1 March 2009 of the furniture and fittings was determined as four years.

10 Management is of the opinion that there might be a possible impairment in the value of vehicles due to hail damage.

On 28 February 2010 the vehicles can be sold to a knowledgeable, willing buyer for R81 200. Sales commission to an agent will amount to 8% of the total sales price. Management determined that the value in use of the vehicles is R73 278, using an appropriate discount rate of 6%.

The following depreciation rates and methods are applicable:

Asset category	Depreciation rate	Depreciation method
Property, plant and equipment		
Land	N/A	N/A
Furniture and fittings – old policy	15% p.j.	Reducing balance
Furniture and fittings – new policy	6 years	Straight-line
Manufacturing buildings	25 years	Straight-line
Equipment (Sold)	5 years	Straight-line
Production equipment	1 250 units	Production unit
Production control system	3 years	Straight-line
Vehicles	5 years	Straight-line

12 The estimates of depreciation method, useful life and residual values are reviewed annually and have remained unchanged for all assets, except otherwise stated.

13 There had been no indication of impairment at the end of any of the financial years since acquisition of any of the assets of Concept Manufacturing Limited, unless otherwise stated.

General

14 You can ignore the effects of taxation and VAT.

15 Any government grant received, related to an asset, will decrease the carrying amount of the asset.

REQUIRED:

(a) Calculate the profit or loss on the disposal of the equipment of Concept Manufacturing Limited for the year ended 28 February 2010 in accordance with Statements of Generally Accepted Accounting Practice. (4)

(b) Calculate the carrying amount of each non-current asset of Concept Manufacturing Limited on 28 February 2010, in accordance with Statements of Generally Accepted Accounting Practice. (17)

(c) Prepare the Revaluation surplus **column** in the Statement of changes in equity of Concept Manufacturing Limited for the year ended 28 February 2010 in accordance with Statements of Generally Accepted Accounting Practice. (4)

(d) Prepare the following notes to the annual financial statements of Concept Manufacturing Limited for the year ended 28 February 2010 in accordance with Statements of Generally Accepted Accounting Practice:

- ☐ Provisions
- ☐ Related parties
- ☐ Property, plant and equipment (*columns* for the new production unit only) (18)

(e) Prepare only the general journal entries with regards to the government grant received by Concept Manufacturing Limited for year ended 28 February 2010, if the grant was recognised as income, instead of a decrease in the carrying amount of the asset. (7)

Comparative figures are not required.
No accounting policy notes are required.
No total columns are required.
Show all calculations.